

**OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES
HEARING ON REFORMING CREDIT RATING AGENCIES:
THE COMMISSION'S NEED FOR STATUTORY AUTHORITY
TUESDAY, APRIL 12, 2005**

Mr. Chairman, we meet for the third time in the last two years to explore the issue of regulating credit rating agencies. As I have regularly noted during our past examinations, entities like Moody's, Standard and Poor's, and Fitch have long published their views on the creditworthiness of the issuers of debt securities. The significance of these opinions has also greatly expanded in recent years as a result of increases in the number of issues and issuers, the globalization of our financial markets, and the introduction of complex financial products.

Although rating agencies received some scrutiny after the recent surge of corporate scandals, we have not yet mandated any substantive changes in their practices. One witness at one of our past hearings nevertheless noted that the agencies "played a significant role" in Enron's failure. Additionally, a Senate investigative report determined that the monitoring and review of Enron's finances "fell far below the careful efforts one would have expected from organizations whose ratings hold so much importance."

Outside Enron's auditor, the rating agencies probably had the greatest access to non-public information about the firm's complicated financial arrangements. Even with this data, the agencies exhibited a disappointing reliability in the accuracy of their coverage. In fact, the three existing Nationally Recognized Statistical Rating Organizations at the time of Enron's failure rated the company at investment grade until four days before its bankruptcy filing.

The failure of the nationally recognized agencies to lower their credit ratings in a timely manner in this case and other instances -- such as WorldCom's bankruptcy, New York City's debt crisis, Washington Public Power Supply System's default, and Orange County's collapse -- has resulted in great financial losses for many Americans who little understood the true credit risks of their investments.

This issue is therefore one on which we should focus our attention in the 109th Congress. During our past hearings, it has also become increasingly clear to me that while our capital markets and the ratings industry have evolved considerably in recent years the Commission's rules in this area have changed little, even though it has studied these issues for more than a decade. Additionally, the *Washington Post* late last year in a series of investigative reports on credit ratings concluded that although the agencies with national recognition are the "gatekeepers of capitalism" they have no "commensurate oversight or accountability."

The regulation of rating agencies, I believe, is ripe for examination and action. I know that the Securities and Exchange Commission agrees. Today's witness, Annette Nazareth, the Commission's Director of Market Regulation, has previously observed that while rating agencies have generally performed their work well for nearly a century, they have also missed some "colossal" failures in recent years. She has further described our debt markets as "the dark corner" of the securities industry. The time has come to shine some light into this dimly lit field.

Accordingly, I was pleased that the Commission recently finally put forward for public comment a proposed rule to define what constitutes a Nationally Recognized Statistical Rating Organization and the process for making such a designation. While this proposal is a good step, more still needs to be done in the area of rating agency oversight.

The agencies, as I am aware, are also working with the Commission to establish a voluntary framework to improve transparency. While some hope that this agreement will be effective, many have lingering doubts. After all, Chairman Donaldson has already indicated that he does not have the confidence that these discussions will result in substantive reforms because the existing agencies with national recognition have taken the position that they will not allow the Commission to conduct inspections or take enforcement actions.

As you know, Mr. Chairman, top officials at the Commission have also regularly suggested that additional legislative authority may be needed in the area of rating agencies. Consequently, I have now come to conclude that it is time for us to ask the Commission what specific authorities it believes it needs to effectively oversee rating agencies. I will therefore be sending a letter to the Commission after today's hearing to request this technical assistance.

The Congress will ultimately decide whether to consider a bill related to these issues, but obtaining the insights of the experts at the Commission will help us in crafting an appropriately balanced piece of legislation that addresses First Amendment concerns. Learning of the Commission's views now on the needed statutory authority will also help us to expedite future action if the voluntary framework negotiations break down or result in a flawed product.

In closing, Mr. Chairman, we must act to ensure the continued integrity of the rating agencies and the credit rating process. I also look forward to hearing from our witness today and to moving forward prudently and promptly on these important matters.

April 12, 2005

The Honorable William H. Donaldson
Chairman
U.S. Securities and Exchange Commission
450 Fifth Street, NW, Room 6000
Washington, DC 20549

Dear Mr. Chairman:

As you know, the House Financial Services Capital Markets Subcommittee is very interested in the activities of U.S. Securities and Exchange Commission regarding Nationally Recognized Statistical Rating Organizations. Accordingly, to facilitate possible legislative action on these matters in the 109th Congress, this letter requests your technical assistance in providing greater detail about the specific statutory authorities that the Commission may need to improve regulatory oversight of all credit-rating institutions generally and nationally recognized agencies specifically.

Like many of my colleagues, I want to ensure that rating agencies operate effectively, efficiently, and ethically, in order to ensure that Americans understand the real credit risks of their investments. In your recent testimony before the Senate Banking Committee you also noted that “a well-thought-out regulatory regime could provide significant benefits [for investors] in such areas as record-keeping and addressing conflicts of interest in the industry.” I agree with these assessments.

You additionally indicated in this testimony that “legislation may be needed” in this area, even if the Commission and the nationally recognized rating agencies do develop and implement a voluntary framework to improve industry oversight. You further commented that the Commission “would stand ready to work with Congress on crafting appropriate legislation if Congress determines that such legislation is necessary.”

As you know, I have previously called on the Commission to take “prompt and prudent action” to address long-lingering questions related to the supervision of credit-rating agencies. Based on your recent comments before the Senate Banking Committee, several similar public statements made by other senior officials at the Commission, and the limited, but useful, regulatory proposal recently released by the Commission, I have concluded that it is now time to ask what specific legal authority would be needed to effectively oversee rating agencies. Consistent with all applicable law and regulation, I would therefore appreciate receiving your

technical assistance in providing draft legislative language that Congress could use if it ultimately determined that it was appropriate to create a comprehensive oversight regime for credit-rating agencies.

Obtaining your insights at this time will help us in crafting an appropriately balanced piece of legislation should we decide to take action on these matters during the 109th Congress. Learning of your views now on any needed statutory enhancements will additionally help us to expedite future legislative action if the voluntary framework negotiations should break down or result in a flawed product. It will also ensure that we address First Amendment considerations, legal precedents, and the specific issues raised in the two concept releases previously issued on these matters.

In addition to providing technical assistance, please continue to keep me informed of the Commission's progress with respect its recent rule proposal related to Nationally Recognized Statistical Rating Organizations and its negotiations with interested parties over a voluntary framework. As for myself, I have not yet concluded the most appropriate way to resolve this problem. It is nonetheless my expectation that the Commission and Congress will eventually act in a way that protects investors without imposing unnecessary regulatory burdens on the securities industry.

In closing, I look forward to receiving your response and request that it be forwarded to my office by June 6, 2005.

Sincerely,

/s/

Paul E. Kanjorski
Member of Congress

PEK/tmh